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THE GERMAN BOURSE LAW.

BY G. PLOCHMANN.

IN the special message sent to Congress on the 31st of January, 1908, the President of the United States condemns speculating in securities and commodities as a pernicious practice, and urges the introduction of legislative measures to remove this unhealthy feature from our business life. It is suggested that "we should study both the successes and the failures of foreign legislators who, notably in Germany, have worked along this line, so as not to do anything harmful"; and, indeed, the experience of Germany in this particular field of legislation furnishes a timely and interesting object-lesson.

The German Bourse Law of 1896 is the creation of the Agrarian Party, which considered speculation in grains and other commodities to be an unsettling and unfavorable market factor and detrimental to agricultural interests.

A similar view was taken of speculative transactions in stocks and securities, where, during former periods of excited activity, unhealthy signs of business immorality had appeared that rendered reform imperatively necessary.

A Bill, known as the Bourse Law of 1896, was passed in the Reichstag on June 22d, 1896, by the majority, composed of the Centre and Conservative Parties, against the opposition of Liberals and Socialists, and became operative on July 30th of the same year.

The New Law: Its Scope and Its Effect.—Three measures were introduced to check the evils of speculative trading:

1. Trading for future delivery in grain and other commodities, and in mining and industrial securities, and in the securities of all corporations having a capital of less than 20,000,000 marks

was prohibited. No longer were the markets to be influenced by the raids of professional gamblers, who, by selling commodities or securities which they did not possess, or by making fictitious purchases for which they did not intend to pay, worked havoc with the laws of supply and demand. No longer should it be possible for small corporations of doubtful standing to dispose of their shares at a substantial premium, by creating an artificial demand for their own stock, thus attracting the money of guileless investors.

2. An addition to this measure was the so-called Bourse Register. Banks, brokers and investors who intended to trade in futures, where such trading was still permitted under the new law, had the option of entering their names in this register for an entrance fee of 150 marks, and an annual fee of 25 marks, and they were then legally bound to fulfil all obligations arising out of such transactions. If the name of one of the parties to a contract did not appear on the Bourse Register, such contract was void and the settlement of a claim could not be enforced by law. It was expected that this Register would be used only by those engaged in financial affairs whose standing fully qualified them to deal on the Stock Exchange, and that all undesirable persons would be deterred from filing their name, as that might publicly brand them as professional gamblers and jeopardize their reputation.

3. To complete the work of the anti-gambling crusade, the restrictions already imposed upon trading for future delivery were rendered more severe in 1900 by a new law (Section 764 of the German Civil Code), which provided as follows:

“If a contract for the future delivery of commodities or securities has been closed with the intention that the difference between the price agreed on and the Stock Exchange or market price at the time of delivery shall be paid by the loser to the winner, such contract is to be considered as a wager. This shall also apply if only one of the contracting parties intends that the difference should be paid and the other party knows or should know such intention.”

According to the Gambling and Betting Act (Section 762 of the German Civil Code):

“No liability can be established through gambling or betting. Money lost through gambling or betting cannot be recovered on the plea that no liability existed.”

It will readily be seen that the new law placed gambling on the Stock Exchange on a par with gambling at cards or on the race track, and denied its devotees all further consideration.

To protect irresponsible persons against their own errors of judgment, to weed out undesirable manipulators, to purify business life: that was what the well-meaning German legislators fondly hoped to accomplish—the familiar old tune, that has been sounded since the days of the tulip mania at different times in every country. Alas! “the best laid schemes of mice and men gang aft a-glee.” The objections of those who were opposed to the passage of these measures have been justified by the financial history of the last twelve years. The Bourse Law of 1896 has proved the most disastrous failure in the economic life of the German people, and has destroyed the prestige of the Berlin Stock Exchange for years to come.

Prior to the enactment of the Bourse Law, the bulk of all Stock Exchange transactions consisted of trading for the account. A settlement took place at the end of every month, when commitments were either liquidated or carried over to the new account, very much as is done in London twice a month. From the character of the daily trading a fairly precise *guess* could be formed of the financial requirements that would have to be met at the approaching settlement, and preparations could accordingly be made to meet the demand in such a way as to minimize the strain upon the money market. This task was considerably simplified through the accumulation of trades during a whole month, of which many could eventually be compensated without transfer of capital.

It must not be inferred from this that these settlements always passed off quite smoothly; on the contrary, they proved very trying at times when money was also in brisk demand for other purposes. But it is not too much to say that the liquidation, all over the country, of the monthly account, that used to run into quite large proportions in active times, could in fairly normal times be accomplished without creating more than a temporary flutter in the money market. Arrangements for monthly renewal loans were made all through the month, and money that could not be profitably employed in other channels readily found its way to the principal cities of the country, thus helping to satisfy the needs of the Stock Exchange settlements.

The restrictions imposed upon trading for the account changed all this. Transactions for future delivery which could be settled, as heretofore, once a month, were now limited to a comparatively small number of securities, principally those of large banks and transportation enterprises. By far the majority of all securities listed on the Board were outclassed under the new rules, and could henceforth be dealt in only on a cash basis. Every day became a settling day now, with more or less extensive requirements of capital that had to be provided at short notice. People in this country, where the highest rates for accommodation are paid, can appreciate what that means.

To corroborate once more the time-honored experience that laws are made to be evaded, a subterfuge was discovered to get around the embargo put upon trading for the account which increased the demand for ready money.

A deal in futures, according to the new law, is a contract which provides that the delivery of securities or commodities, as well as the payment of the price, shall be put off to some future date, agreed upon by the contracting parties. These two characteristics, according to legal definition, go to make up a time bargain. As long as the delivery *only* was postponed, but the purchase price paid at once, the contracting parties would not violate the law.

A new practice of trading followed this discovery. In almost all the listed securities, trading for future delivery was resumed in spite of the restrictions imposed by the law. Such transactions were disguised in the following way:

Supposing a man of good repute and standing, but not in possession of sufficiently large cash resources to pay for all his commitments, wanted to operate in that section of the market where trading for the account was unlawful; all he had to do was either to pledge his good credit or put up reasonable margin with his brokerage house or bank and have his orders executed under a special arrangement, whereby the delivery of all securities bought or sold for his account was to be postponed to some future date in his option, whilst his account was to be charged at once for the full purchase price or be given credit for amounts realized on sales. The law enforced cash transactions, but it could not enjoin commission houses from advancing their own cash to clients whose business they wished to retain.

Although these pay-up-at-once-and-deliver-when-you-like transactions did not violate the letter of the law, they once more opened the door to stock jobbing, short sales and gambling for a turn; and differed from the prohibited form of trading only in that they were harder to finance.

The increased demand for currency coming from the Stock Exchange has, without doubt, greatly intensified the acute monetary stringency with which Germany has had to contend during recent years, owing to its rapid expansion in the industrial field.

The private bankers and brokerage houses soon found the new conditions too onerous for their limited resources of capital. An unequal struggle set in between them and their powerful competitors in the brokerage business, the Joint Stock Banks. The smaller houses became either entirely dependent upon the Banks for help to enable them to carry on their business or had to go out of business altogether.

From the statistics published by the German Bankers' Association one may learn that in 1891-1896, the number of private bankers decreased by 32, and in 1897-1902 by 125; whilst in 1891-1896 the number of Public Banks increased by 65, and in 1897-1902 by 207. These figures bear witness to a predominance of large aggregations of capital over smaller ones on the floor of the Stock Exchange, which surely is not desirable. Valuable connections that had carefully been fostered for years were broken up or diverted to foreign markets. Being deprived of an active speculative interest and of many of its former leaders and their following, the market became highly susceptible to unfavorable developments and rumors; and, in the absence of all steadying influence, any adverse factors were accompanied by fluctuations such as had rarely been witnessed in former times.

The outbreak of the Russo-Japanese war, for instance, in which German politics were hardly involved at all, was followed by a much more severe decline on the Berlin Bourse than the one which took place in Paris and London, although French capital had a much more direct interest in the success of the Russian arms.

Not less destructive to legitimate business was the effect directly attributable to the introduction of the Bourse Register and the extension of the Gambling and Betting Act to fictitious time bargains. It was found that the less prominent private bankers,

who also accepted money on deposit, did not care to file their names on the Register, for fear that their reputation as conservative bankers might become injured.

Since the Gambling Act was extended to trading for a difference, bankers and brokers did not care to trade in stocks and securities, as they preferred not to run the risk of losing their own money, as they might do if a customer should fail to make good an eventual loss and secure his immunity by pleading in Court that his name was not on the Bourse Register, or that he only wanted to take advantage of the fluctuations in the market. In quite a number of cases, the protection of this unjust law was resorted to by persons who had been identified with stock operations for years.

German capital was diverted to the financial centres of other countries, where, unhampered by legislative interference, it might find such scope as had been denied it at home. During the years following the enactment of the Bourse Laws, German capital amounting to many millions of dollars went to London and New York, and were there invested in railroad securities or in shares of industrial corporations and mines, which proved a great injury to Germany, as a very large proportion of this money left the home country never to return. Thus it can be seen that the movement of funds through bank channels was greatly diminished, which resulted in interrupting the success of many financial undertakings.

Among business men the Bourse Law came to be regarded with the utmost apprehension, and the whole financial community combined in rare unanimity to take up the fight for a thorough revision of the law. The trend of popular feeling is best illustrated by a reference to the annual reports of the principal banks. Following are a few quotations:

"The prices of all industrial securities have fallen. This decline has been felt all the more as, by reason of the ill-conceived Bourse Law, it struck the public with full force without being softened through covering purchases of speculative interests."—*From the report of the Deutsche Bank for 1900.*

"A serious political surprise would cause the worst panic, because there are no longer any dealers to take up the securities which, at such times, are thrown upon the market by the speculating public."—*From the report of the Deutsche Bank for 1904.*

"In our last report, we referred to the great danger which may be

brought about through delaying the revision of the Bourse Laws, and we are now pointing to it again because we consider it our duty to impress again and again a wider circle of the public with the economic value of the Stock Exchange, and its important relation to our financial preparedness in times of war."—*From the report of the Deutsche Bank for 1905.*

"If it had still been necessary to furnish proof of the regrettable fact that the German Bourses are no longer able to accomplish their task—equally important to the welfare of the people as to the standing of the Empire—the trend of events during the past financial year in general, and the result of the last German Government issues in particular, would have furnished that proof."—*From the report of the Deutsche Bank for 1906.*

"The danger, which lies in the ban put on speculation, especially in the prohibition of trading for future delivery in mining and industrial securities, will become manifest to the public if, with a change of economic conditions, the unavoidable selling force cannot be met by dealers willing and able to buy. It will then be too late to recognize the harmful effects of the Bourse Law."—*From the report of the Dresdner Bank for 1899.*

"The unfortunate Bourse Laws continue to be a grave obstacle to business activity."—*From the report of the Disconto-Gesellschaft for 1902.*

"The Bourse will not be able to resume its important economic functions till the restrictions upon trading for future delivery have been removed."—*From the report of the Disconto-Gesellschaft for 1903.*

The Bourse Law has been the all-absorbing topic of financial discussion in recent years. Thanks to the unremitting efforts of public-spirited men, the Government appears to have at last seen the folly of continuing its mistaken policy, and has promised a thorough revision of the Bourse Law which is now before the Reichstag and will, no doubt, be passed upon within the next few weeks.

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